by the central office. This provision is included for the convenience of the central office. It is reasonable that a provider group allocate the salary costs associated with the same consultant to the same category in all facilities served to avoid confusion and simplify the job of auditing.

It is reasonable that top management not be considered consultants for purposes of this item in order to eliminate the incentive to circumvent the limits on administrative costs and top management compensation by allocating a portion of their compensation to other cost categories. or facilities

The consultant's entire job responsibility must be to provide these consulting services to eliminate the possibility of cost shifting administrative costs to other categories by claiming administrative staff as consultants.

Item C specifies that, except as provided in item A and B, central, affiliated or corporate office costs must be allocated to the administrative cost category of each facility served. This item specifies how these costs are to be allocated. It is reasonable to use direct identification whenever possible because this is the most accurate way to allocate costs, and direct identification is also consistent with the requirements in subpart 1. Those costs which can be directly identified with a specific operation unrelated to the facility's operation must be allocated to that unrelated operation based upon the ratio of expenses. For those operations which have business operations other than ICFs/MR, the central office cost must be allocated between operations so that reimbursement is not made for costs unrelated to ICF/MR operations. It is reasonable to make this allocation on the basis of expenses since expenses are common to all types of business operations and the information will always be available. Also, the level of expenditures reasonably reflect the involvement of the central office.

Subitem 4 is necessary for those ICF/MR operations which have facilities both in Minnesota and other states. First the central office cost must be allocated to Minnesota ICF/MR operations and ICF/MR operations in other states. Then, the remaining central office costs must be allocated to each facility in Minnesota. Since costs which can reasonably be directly identified have been treated in that manner, it is reasonable that the remaining costs in subitems (4) and (5) be allocated uniformly over each facility by resident days since, at this point, each facility would be expected to benefit to the same degree.

The method described above is reasonable since direct identification is the preferred method of assigning costs to operations and that method is used first. Costs that cannot be directly identified are then allocated as appropriate on the basis of expenses or resident days. Both basis of allocation produce a reasonable allocation of costs to different operations or to different facilities.

Item D. It is reasonable to allocate the cost of a capital asset to the facility using the assets because if the facility had to purchase the asset, it would incur those costs. Also costs must be for goods or services allowable under subpart 15. Therefore, these costs could not be allocated to any facility other than the facility which uses the asset. It is reasonable to allocate the cost of capital assets not directly used by a facility using the methods described in Item C and to simplify the allocation process by using similar procedures whenever possible.

Item E specifies that the useful life of a capital asset maintained in a central office is determined in the same manner as it is for the facility, except for equipment. It is reasonable to have an exception for depreciable equipment because the useful life of depreciable equipment in the facility is considered to be only five years due to expected excess wear and tear on equipment by the residents. Central office equipment is not subject to such wear and tear, and therefore, the useful life for each piece of equipment established in the depreciation guidelines is more appropriate.

Part 9553.0030 Subpart 5, Allocation of Costs to Related or Non-Related Organizations.

Statement of Need:

It is necessary to allocate the facility's cost of providing goods or services to a related organization or non-related organization so that it is possible to identify those costs attributable to those organizations and separate them from ICF/MR costs.

Reasonableness:

Subpart 5 specifies that direct and indirect costs of goods and services provided for related and nonrelated organization must be directly allocated to that organization so that they can clearly be identified as nonallowable costs. It is reasonable that these costs are not allowable costs because they are not costs incurred in providing ICF/MR services within the facility and should not be reimbursed by the medical assistance program through that facility's payment rate.

Part 9553.0030. Subpart 6. Payroll Tax and Fringe Benefit Cost Allocation.

Statement of Need:

It is necessary to allocate payroll taxes and fringe benefits to each of the other operating cost categories in order to insure the proper reporting of compensation. It is also necessary to specify a method for allocating payroll taxes and fringe benefit costs among operating cost categories so that providers know how this is to be done.

Reasonableness:

Allocation of costs reported in the fringe benefits and payroll tax cost category is done based on the ratio of allowable salary costs in each of the other cost categories because this is consistent with Generally Accepted Accounting Principles.

V. DETERMINATION OF ALLOWABLE COSTS - Part 9553.0035

Part 9553.0035 Subpart 1. Allowable Costs

Statement of Need:

Minnesota Statutes, section 256B.501, subdivision 2, requires that the commissioner establish procedures and rules for determining rates to be paid by the department to facilities in the Medical Assistance Program. These rates must be based upon methods and standards which provide for "the costs that must be incurred." Furthermore, the legislature stated that rates must

be adequate to provide for costs incurred in "efficiently and economically operated facilities." The statute also indicates that the rules "shall specify the costs that are allowable for payment through Medical Assistance."

Reasonableness:

The Legislature authorized the Department to reimburse only for "costs that must be incurred." A cost which must be incurred is one which is necessary to resident care.

The Department is obligated to make a determination of what costs are allowable by holding such costs to a standard of necessity which relates to resident care. The department serves as a buyer of services on behalf of a dependent population and maintains fiscal responsibility to the taxpayers of the state of Minnesota and to the federal government. A clear definition of allowable costs is essential in a cost-based reimbursement system. Otherwise, the Medical Assistance Program would be accepting any costs as necessary and might be assuming a financial burden for costs that are unrelated to resident care. Part 9553.0035 establishes procedures necessary to make a determination of allowable costs and, part 9553.0036 details those specific costs which are to be disallowed.

Subpart 1 states as basic policy that only allowable costs may be used to compute the total payment rate. It is reasonable that nonallowable costs not be included in the payment rate since to do so would provide public payments for items which are not related to resident care or are otherwise not allowed by federal requirements, state statutes, or public policy.

Part 9553.0035 Subpart 2. Licensure and Certification Costs.

Statement of Need:

In order to provide ICF/MR services, requirements for licensing and certification under applicable federal and state laws, federal regulations, state rules, and local standards must be met by the facilities. The cost of meeting the applicable licensing and certification standards are allowable costs.

Reasonableness:

Medical Assistance pays for costs "that must be incurred" in order to provide services. Without licenses, the facility cannot provide services. Without certification, the facility cannot get Medical Assistance reimbursment. Therefore, the cost of meeting the applicable licensing and certification costs are "costs that must be incurred" and so qualify as allowable costs. In addition, 42 CFR § 447.253 provides that states participating in the Medical Assistance program and receiving federal funds must make assurances that federal health standards are being maintained. Since the federal standards and other state health standards are legally mandated and essential to resident care, it is necessary and reasonable to allow such costs in the rule. This subpart refers generally to the costs incurred by facilities to meet the requirements set by governmental agencies and is not limited to the costs of obtaining a license. However, such license fee costs are allowable under the rule.

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Part 9553.0035 Subpart 3. Services Costs.

Medical Assistance pays for costs that must be incurred to provide services. It is necessary to specify in the rule the costs of service including program, administrative, and property costs, which will be allowable.

Reasonableness:

Subpart 3 specifies that cost of services are allowable and indicates which costs are considered costs of services which "must be incurred" and are therefore allowable for the purpose of setting facility payment rates. It is reasonable that such information be specified so that providers know which costs are allowable. The definitions of and limitations on what is included in service costs are contained in part 9553.0040 and are referenced in this subpart. See part 9553.0040 of the Statement of Need and Reasonableness for these definitions and limitations.

Part 9553.0035 Subpart 4. Applicable Credits.

Statement of Need:

Subpart 4 requires that income or adjustment to costs received by the facilities which relate to costs incurred by the facility must be applied to reduce or offset such expenses to the extent that the cost to which the credits apply was claimed as a facility cost. This provision is necessary to prevent duplicate payments for the same costs so that the state and federal governments are not paying for the same costs for which the facility has already been compensated.

However, it is also necessary to allow gifts and donations from non-governmental sources to be exempted from this provision so that the benefits of receiving such gifts or donations remain intact and facilities have an incentive to raise funds.

Payments made by the commissioner to the provider for approved services for very dependent persons with special needs are exempted from this provision since the additional cost of providing services to very dependent persons with special needs is not an allowable cost under these rule parts.

Reasonableness:

It is reasonable to reduce the facility's cost by any income or adjustment related to those costs, so that the state and federal governments are not paying for costs for which the facility has already been compensated, or for costs that are otherwise reduced. It is reasonable that public funds be used to pay for net costs.

Because the state wants to encourage fund raising since it benefits residents and fund raising costs are nonallowable costs, it is reasonable to exempt gifts and donations from nongovernmental sources from this principle.

Since the expenditures for services for very dependent persons with special needs are nonallowable costs, the income received by the facility should not be used to further reduce the facility's costs. To do so would be unreasonable and violate the principle which states that applicable credits are offset to costs only if these costs were claimed as facility costs.

Part 9553.0035 Subpart 5. Documentation.

Subpart 5 specifies the requirement for documentation to support costs used to establish the payment rate. Authority for these requirements is contained in Minnesota Statutes, sections 256B.501 and 256B.27. Documentation to support costs is necessary in order to facilitate any review of records by the auditors to determine the validity of the transaction and its relationship to facility operations. Guidelines for documentation are established in Items A, B, C, D, and E.

Reasonableness:

Item A establishes the guidelines for what will constitute adequate documentation:

Subitem 1. It is reasonable to require that such documentation be maintained in orderly files so that the tasks of auditing and administration can be effectively performed.

Subitem 2. Since a provider may own more than one facility, it is necessary to require that providers keep facility files separate unless a combination of files would not hinder tracing a transaction when auditing is done.

Subitems 3. & 4. It is reasonable to require that providers maintain the documents listed so as to enable the Department to assess the costs incurred and determine their reasonableness and relationship to resident care. If providers were allowed to dispose of such documents at their discretion, the department auditors would be unable to verify costs.

Subitem 5. Minnesota Statutes, section 256B.27, subdivision 1 authorizes the commissioner to require any reports, information, and audits of medical vendors which he deems necessary. He also has general authority, as provided under Minnesota Statutes § 256B.04, subdivision 2, to make uniform rules and regulations for the Medical Assistance program. It is reasonable to require facilities to keep records to support the five most recent annual cost reports so that the records are available for field audit on a four year schedule. Minnesota Rule, part 9500.0930, subpart 4 has a similar requirement.

Item B specifies the information which must be maintained to document costs for consultant, professional, or purchase service contracts. It is reasonable to require that providers maintain the listed documents so that records may be audited to determine whether the service was actually provided, whether the cost of service was an allowable cost, and whether the cost was reasonable.

Item C indicates that documentation must also be adequate to support costs attributed to compensation. The Department is obligated to know the services for which it pays. Compensation costs are among the most significant components of cost in the provision of ICF/MR services. Therefore, it is necessary to require the documentation of such costs. It is reasonable to require that such payroll records be supported by time records since it is incumbent upon the Department to ascertain that value received is equivalent to value compensated.

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The allocation of salaries to more than one cost category is permitted under part 9553.0030. It is, therefore, necessary and reasonable to require documentation of such allocation.

Item D recognizes the practice of using a single vehicle for both business and personal purposes and, therefore, requires logging of such use so as to enable the state to pay only for the mileage related to the operation of the facility. The keeping of such a log is a reasonable requirement to be placed upon those who receive compensation from the state.

Part 9553.0035 Subpart 6. Compensation for Personal Services.

Statement of Need:

Subpart 6 deals with the determination of allowable costs of personal service. Specific consideration of compensation for personal services is necessary because labor costs compose about 70 percent of facility expenses and increases in wage rates and fringe benefits have a dramatic effect on average daily costs. (Policy Analysis Series, No. 6, 1982: p. 6.) It is necessary to itemize the components of compensation so that ICFs/MR vendors have guidance as to what constitutes allowable compensation.

Reasonableness:

Item A indicates what is included in compensation. It is reasonable that the Department provide such guidance. Vacation and sick leave are considered compensation only if the employee is vested. It is not reasonable for the state to make payment for vacation and sick leave based upon estimated future costs when these benefits may never be paid due to staff turnover. Although under generally accepted accounting principles compensation includes accrued vacation and sick leave benefits and not merely vested amounts, Financial Accounting Standards Board (FASB), Standard No. 43, permits regulated industries to deviate from the standard for rate setting purposes. In addressing the need for and reasonableness of a similar provision in Rule 50, Judge Lunde concluded "since the rule is designed to pay actual, current costs, it is concluded that the Department's proposal to pay only for vested sick leave and vested vacation benefits is a necessary and reasonable one and that the Department is not required to fund accrued benefits which may never be paid." (Lunde Report, 1985: p. 30.)

Item B requiring a written policy governing payment of compensation, is necessary to assure that the payment rate reflects actual time spent and services provided and that the level of compensation is reasonable for the type of services provided the individual.

Item C is necessary to insure that unnecessary service is not compensated. This is reasonable because Mininesota Statutes, section 256B.501, subdivision 2, authorizes the commissioner to provide for the costs that must be incurred for the care of residents.

Item D insures that the state pays for actual and necessary work and that employees receive the compensation in a timely manner. Without this requirement, a provider may incur a cost and receive reimbursement which is not then passed on. This reimbursement is incorrectly retained by the facility to the detriment of the public, residents, and the employees. The 122 day time period is selected to be consistent with the time allowed facilities to complete their cost reports, including a possible extension. See part 9553.0041, subpart 9.

Item E specifies that reimbursement for services provided on a part-time basis be proportional to that compensation paid for services rendered on a full-time basis so that part-time service provision is proportionally no more or less renumerated than full-time service.

Part 9553.0035 Subpart 7. Limitations on Related Organization Costs.

Statement of Need:

Subpart 7 deals with allowable costs attributed to related organizations. A "related organization" is one which possesses a common identity with the provider seeking reimbursement under the Medical Assistance program. That common identity may be expressed in terms of legal ownership or actual control. It is necessary to take into account the costs which may be attributed to related organizations in order to prevent the payment of public funds for activities unrelated to resident care. If the provider seeks payment for costs incurred in transactions with related organizations, it is necessary to insure that those costs are not excessive when compared to the prices of comparable services purchased in an arms-length transaction. The related organization costs must not include a mark-up or profit, since these transactions are equivalent to doing business with oneself.

If the related organization sales to nonrelated organizations constitute at least 50 percent of annual sales of similar items or services, then it is necessary to recognize the price charged to nonrelated organizations since the Department wants to insure that it pays for the costs of goods and services obtained at competitive prices.

Reasonableness:

It is reasonable to recognize charges for goods and services from unrelated organizations because it may be assumed that such goods or services are acquired in a marketplace of arms-length transactions. It is also reasonable to recognize charges for goods and services from a related organization which does at least 50 percent of its business with unrelated entities since the competitive market is a reliable indication that pricing is not controlled.

Subpart 7 does not purport to ban the use of alternative business entities nor does it seek to invalidate all those costs attributed to transactions between a facility and its related organizations. The subpart subjects such costs to reasonable oversight in order to enable the Department to regulate the transactions between such entities for the purpose of determining allowable costs.

Subpart 7 states that costs applicable to services, facilities, or supplies furnished by a related organization are includable as allowable costs if such costs do not exceed the price of comparable services, facilities, or supplies purchased elsewhere. The requirement is similar to 42 CFR § 405.427 which is used by the federal government to govern payments to related organizations under the Medicare Program.

The subpart establishes 50 percent as a threshold figure because sales which exceed 50 percent will subject the related organization to market controls resulting from arms-length transactions. The proposed rule is designed to encourage arms-length transactions.

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Part 9553.0035 Subpart 8. Capitalization.

Statement of Need:

It is necessary to specify how and when to capitalize a given asset so that providers complying with the rule and auditors enforcing the rule will have standards to follow and a common frame of reference.

Reasonableness:

It is reasonable to specify how assets are to be capitalized, and to establish a threshold for an asset to be claimed as a current expense. The standard used is similar to that employed in rule parts 9549.0010 to 9549.0080 and to that used by Medicare for its cost findings in the Medicare Program. (See Medicare Provider Reimbursement Manual HCFA-Pub. 15-1, section 108.) Also, since the Department's auditors and the provider's accountants often work with both the nursing home and ICF/MR rate setting policies, it is important and less confusing to have the standards for capitalization of assets similar. In the long run, this would have the effect of reducing appeals since a significant body of decisions could be employed to informally resolve disputes on whether or not an asset should be expensed in the year acquired or capitalized. While other methods could have been proposed, the department believes that this method is a reasonable one and will result in uniformity among providers and programs.

Part 9553.0035 Subpart 9. Working Capital Interest Expense.

Statement of Need:

Some working capital is necessary to finance the cash flow needs of facilities. The need for working capital is sometimes precipitated by the approximately 20-day lag in Medical Assistance payments following the month the service was actually provided.

Reasonableness:

The need for working capital should decrease under the provisions of the proposed rule since the payment rate the provider will receive, will be established prior to the beginning of the rate year. If the rule is adopted as proposed, the need for working capital should be greatly reduced if the facility properly manages its expenses. The reason for this is the cumulative effect of positive cash flows in the first portion of the rate year which, when properly managed, provide a decreasing need for working capital. Part 9553.0060, subpart 3, item 1, provides the provider with the appropriate incentive since interest income earned is not subject to offset. The payment rate is an average rate for the reporting year or the interim period and the expenditures for many items included in the rate such as salaries, supplies, and purchased services tend to be greater in the last half of the reporting year or the interim period. The result is that, to a certain extent, the payment rate results in a positive cash flow during the first part of the reporting year or the interim period. Also most items are not required to be paid out on a daily basis. For example, salaries generally lag the incurrence of the liability by two to four weeks. Items such as real estate taxes are paid semi-annually and payroll taxes and other employee benefits may be paid quarterly. Additionally, most supplies and food expenses do not require payment for at least 30 days from the date of purchase. Therefore, the actual need for working capital is greatly reduced. Working capital interest expense for eleven facilities currently

on an interim rate .19 percent to 8.32 percent of total operating costs. Of those facilities, only four are over the limit established in these proposed rule parts (1.64%, 2.72%, 8.00%, and 8.32%). The average for the remaining facilities is .3 percent. Therefore, it is reasonable to establish the estimated need for working capital interest expense during the interim period at 1 percent of total operating expenses. For the year following the settle up, it is reasonable to limit working capital interest expense to 80 percent of the amount allowed during the interim period since the need for working capital should decrease once the facility is filled up and the operation stabilized.

For existing facilities, the rule proposes specific limits only during calendar years 1984 and 1985. After that, working capital will be limited only by the overall limit placed on administrative costs. This is reasonable to insure that the historical base upon which the limits are based are not inflated by excessive amounts of working capital interest expense.

Part 9553.0035 Subpart 10 Retirement Contribution.

Statement of Need:

Retirement contributions are an important employee benefit which, in addition to providing for retirement, encourage employees to maintain employment in the facility. Retirement contributions are allowable costs. However, it is necessary to limit these contributions to meet the cost containment mandates of the legislature (Minnesota Statutes, section 256B.501, subdivision 3).

Reasonableness:

To meet legislative cost containment mandates, it is reasonable to limit the retirement contributions to the cost of either a United States Internal Revenue Service approved pension plan or profit sharing plan, but not both. Additionally, the department believes this is reasonable since such plans are governed by federal law and thereby afford the employees the protection and vesting requirements established therein.

Part 9553.0035 Subpart 11. Therapeutic Overnight Trips.

Statement of Need:

As part of the process of creating a normal living environment for the ICFs/MR resident, residents are taken camping or on vacations. Facilities are allowed to use specified facility resources for such trips. Additionally, up to $300 per year per resident for fees, travel, lodging, and meals, is an allowable expense.

Reasonableness:

It is recognized that resident vacations can be a legitimate part of a facility's therapeutic programs and as such are an allowable cost. However, it is reasonable to limit the amount allowed for travel. The $300 limit was a historical basis in the previous rules (Rule 53 Temporary). The original $300 limit was arrived at after deliberation with providers, advocates, and agency staff. It is reasonable to continue this limit given the legislative mandate for cost containment (Minnesota Statutes, section 256B.501, subdivision 3), and considering that a large portion of the cost for these

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activities such as staff salaries, supplies, and equipment is reimbursed elsewhere in these rule parts.

Part 9553.0035 Subpart 12. Preopening Costs.

Statement of Need:

Preopening costs are those operating costs which are incidental to the initial establishment of an ICF/MR. The cost immediately before opening the facility (within 30 days) are expenses of the interim period. Generally the greater proportion of preopening costs are incurred within 30 days preceeding opening of the facility and represent staff time necessary for interviewing and hiring the facility's personnel and acquiring initial food and supply items.

Reasonableness:

Item A. Since much of the preopening costs associated with opening the facility are incurred just prior to opening the facility and more directly relate to the interim period, it is reasonable these costs should be considered expenses of the interim period.

Item B. Other preopening costs which are incurred more than 30 days prior to admission of residents to the facility should be amortized. It is reasonable to amortize these preopening costs because permitting the expensing of these costs in one period may result in the distortion of the facility's operating cost payment rate which is used as the basis for subsequent rate setting purposes.

Item C. Preopening costs do not include property-related costs because although many of the property costs are incurred prior to the opening of the facility, property costs are handled differently for purposes of payment. The historical costs of capital assets are reimbursed over a longer time period as in part 9553.0060.

Part 9553.0035 Subpart 13. Respite Care.

Statement of Need:

Respite care is defined in part 9553.0020 subpart 44. It is necessary to describe how these costs and days should be treated for reimbursement purposes so that providers offering this service know how the expenses and resident days associated with respite care are treated.

Reasonableness:

It is reasonable that these costs should be allowable costs and the days of service should be counted as resident days since the costs and days represent services similar or comparable to those provided to the facility's other residents.

Part 9553.0035 Subpart 14. Top Management Compensation.

Statement of Need:

It is necessary to limit top management compensation in order to ensure that payments made by the Medical Assistance Program are limited to those costs that must be incurred for resident care. These rule parts provide